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## A DEFINITION OF ACCOUNTING.

J. C. DUNCAN.

The object of this paper is to present a definition of accounting and not a definition of an accountant. In the first place the speaker wishes to call attention to the fact that he does not desire to limit the field of the accountant or the field of the science of accounting. The *Journal of Accountancy* of July, 1906, published an interesting article entitled "The Field of Accountancy", by Professor David Kinley. Professor Kinley sent fifty letters to as many practicing public accountants asking them to define public accountant. He received about forty different replies. In all of the definitions given it is evident that the accountant is expected to do more than one thing. In fact, he is looked upon as a person who has at his command a knowledge of a number of different branches of knowledge, namely, accounting, auditing, and commercial law. For lack of a better term, it seems that the practitioner has selected one branch of his profession to let it indicate the type of service he offers to the community. There would be just as much sense in calling a Certified Public Accountant a Certified Public Auditor as there is in calling him an accountant. A surgeon must know anatomy, physiology, hygiene, pathology, and a number of other branches as well as surgery before he may practice as a surgeon, but the title Medical Doctor means that he has obtained a sufficient mastery of those various branches to be intrusted with the lives of the people in the community.

The profession of General Business Adviser for lack of a better term has selected one branch of the many

services which it offers to the community and uses that branch to designate the entire profession. We cannot therefore make a definition of accounting from the types of services the accountant offers; neither would it be advisable for us to rename the profession, since it has such a distinct meaning in the business world at the present time.

The all-embracing services that the accountant undertakes have brought in their train an extremely vague idea as to what accounting in itself should include, and the examining boards of the various states give as indefinite an idea of the profession as one could hope to find. If we try to make a definition of accounting from the C. P. A. questions set by the various examining boards, we are confronted with a very serious difficulty.

An editorial in the *Journal of Accountancy* for July, 1906, makes the following statement: "It has long been a reproach to the accountancy profession in the United States that the examinations proposed for admission into the profession were exceedingly elementary and in no way comparable with the examinations for admission into the other learned professions. With few exceptions candidates for the C. P. A. degree pass the examinations in commercial law, auditing, and theory of accounts, generally with high marks. Very few, however, pass the examination in practical accounting. The reason for this condition is not far to seek. It is because the first three subjects are generally too elementary to be set as a condition of examination into a profession and because the examination in practical accounting demands of the candidate the working out of puzzles rather than the solution of problems. The problems themselves ordinarily present not the slightest difficulty provided the meaning of the examiners can be clearly determined. Their expression

is generally a matter of taste. A variety of methods are available, of which the examinee selects one, which may or may not suit the examiner."

This criticism, the speaker feels, is an eminently fair one for many state board examinations. In looking over the examinations set by the various states for a number of years past, it seems that many of the examining boards have defined accounting in their own minds as the science of lucky bookkeeping, and the holder of a C. P. A. degree is the lucky bookkeeper who has passed the state board examination. This may keep out of the profession a great number of people, but it is not a selective process and it does the profession no good to make such requirements.

In the first place, bookkeeping should be clearly set apart from accounting. Bookkeeping is the art of recording business transactions according to a logical plan that can readily be interpreted. It begins with the statement of the transaction, and ends when the transaction has been properly journalized and posted to the ledger and tested by a trial balance. Accounting should not concern itself with this division of work, although one must be thoroughly familiar with bookkeeping before he can hope to do accounting. Accounting begins where bookkeeping ends, and is not an art but a science.

A bookkeeper for a business, however, is not thereby strictly limited to making entries for the business and testing them by the trial balance. Unless he desires to become a mere mechanical clerk he should know sufficient accounting to make a loss and gain statement and a balance sheet. But bookkeeping, the art, does stop at the trial balance, because when we get beyond that point we are analyzing and interpreting the recorded business evidence; we are making deductions on a scientific basis.

As the practicing accountant is expected to do more than accounting, so the bookkeeper should be able to do more than just keep books; but that does not affect the scope of the art of bookkeeping nor that of the science of accounting.

George Lisle in his work defines accounting as "The science which treats of the methods of recording transactions entered into in connection with the production and exchange of wealth, and which shows their effect on its production, distribution, and exchange." A little farther on he makes the statement, "Accounting is a branch of mathematics." This attitude on the subject of accounting is open to two objections:

1. Accounting is not a branch of mathematics although we use mathematics to assist us in solving accounting problems. Physics and chemistry use mathematics to assist in establishing their conclusions to an even greater degree than does accounting, yet we should never consider them branches of the science of mathematics. One of the great things which accountants emphasize in good accounting is the complete equation of records. To the speaker's mind the equality should be completed not because it indicates that the accounting is correct from a mathematical point of view, but because it shows both the origin of each transaction and how it has influenced the affairs of the concern, thus giving material for correct analysis by giving us a means of tracing out flaws in entries. One may have very bad, misleading accounting with a balanced set of books, and it would be a poor specimen of an accountant who would accept correct mathematics as a proof of correct accounting. The two following trial balances will illustrate the point that accounting as a science is not a branch of mathematics.

TRIAL BALANCES.

J. Jones		36,000	3,000	36,000
C. Smith		24,000	2,000	24,000
Cash	3,000		3,000	
Real Estate	20,000		20,000	
Machinery	15,000		15,000	
Merchandise	85,000	54,000	85,000	54,000
Furniture & Fixtures	3,000		3,000	
Expense	2,000		2,000	
Salaries	5,000			
Wages	5,000		5,000	
Bills Receivable	4,000		4,000	
Accts Rec.	30,000		30,000	
Bills Payable		3,000		3,000
Accts Payable		55,000		55,000
Total	172,000	172,000	172,000	172,000

Merchandise Inventory \$48,000.

Depreciation—Real Estate \$1,000, Machinery \$1,500, Furniture and Fixtures \$200.

Interest on capital invested and withdrawn 6%.

We take as an illustration a hypothetical case where two men, Jones and Smith, are partners doing a certain business, and another man, Brown, offers to buy one-half interest in the firm on the following terms:

(1) He will invest as much capital as the combined net worth of Jones and Smith in the business at the end of the year.

(2) He will give in addition, for good will, to Jones and Smith twice the profits of the past year.

(3) In determining loss and gain the following depreciation charges shall be made,—Real Estate \$1000, Machinery \$1500, Furniture and Fixtures \$200.

(4) In determining loss and gain the business must pay six per cent interest on all capital invested and the partners must pay to the business six per cent interest on all capital withdrawn.

If the partners, Jones and Smith, know of Brown's intentions at the beginning of the year, several methods might be used in keeping the books, two of which are

tested by the trial balances above and are found to be mathematically correct. In the first case Jones and Smith have paid themselves \$3000 and \$2000 salaries respectively for running the affairs of the concern, and have counted those salaries as part of the cost of production. Under the circumstances the loss and gain account shows that the business has lost money.

## No. 1

## LOSS AND GAIN.

Cost of Goods	85,000	Sales	54,000
Salaries	5,000	Inventory	48,000
Wages	5,000	Loss	1,300
Expense	2,000		
Depreciation			
Real Estate	1,000		
Mach.	1,500		
Fur. & Fix.	200		
Interest			
Jones' Cap.	2,160		
Smith's Cap.	1,440		
	<u>3,600</u>		
	<u>103,300</u>		<u>103,300</u>

## BALANCE SHEET.

Assets		Liabilities	
Cash	3,000	Bills Payable	3,000
Bills Receivable	4,000	Accts Payable	55,000
Accts. Receivable	30,000	Interest	3,600
Merchandise	48,000	Capital	
Real Estate	19,000	Jones	36,000
Machinery	13,500	Smith	24,000
Furniture & Fixtures	2,800		60,000
Loss	1,300		
	<u>121,600</u>		<u>121,600</u>

In the second case each partner adopted the fiction that he gave his services to the concern and withdrew from his capital \$3000 and \$2000 respectively, thus diminishing his capital by the amount withdrawn but in no way affecting the loss and gain account, save to add interest to the extent of \$300 to the gain side. The records show, however, a considerable profit.

No. 2

LOSS AND GAIN

Cost of Goods	85,000	Sales	54,000
Wages	5,000	Inventory	48,000
Expense	2,000	Interest	
Depreciation		Jones Withd.	180
Real Estate	1,000	Smith's Withd.	120
Mach.	1,500		300
Fur. & Fix.	200		
	2,700		
Interest			
Jones' Cap.	2,160		
Smith's Cap.	1,440		
Gain	3,600		
	4,000		
	<u>102,300</u>		<u>102,300</u>

BALANCE SHEET

Assets		Liabilities	
Cash	3,000	Bills Payable	3,000
Bills Receivable	4,000	Accts. Payable	55,000
Accts. Receivable	30,000	Interest	3,600
Merchandise	48,000	Capital	
Real Estate	19,000	Jones	33,000
Machinery	13,500	Smith	22,000
Furniture & Fixtures	2,800	Gain	55,000
Interest	300		4,000
	<u>120,600</u>		<u>120,600</u>

If Brown accepted the equation of the accounts in the second case and the conclusions reached from them by the correct mathematics, he would be paying a steep price for his own ignorance and the other men's rascality.

2. The other objection to Lisle's definition that may be pointed out is that while it states in a general way what accounting should include, it is open to the defect of a narrow interpretation in that it regards accounting as a species of advanced bookkeeping. For quite a while the writers on accounting have taken the narrow interpretation and have regarded accounting as the science which relates to the proper classification of the receipts and expenditures of a business in such a way that the owners may determine the losses and gains and assets and liabilities of the enterprises under consideration. The works



of Lisle, Dicksee, and almost every other writer on the subject have confined themselves more than they should to this restricted phase of the question, and, as a result, we find that there is a tendency on the part of most people to regard accounting in a more narrow light than it should be regarded.

Professor Cole in his recent contribution calls attention to a phase of accounting which, it seems to the speaker, should be emphasized very much more strongly than it has been in the past. A chapter is devoted to the subject entitled "The Place of Statistics in Accounting." In the chapter he points out the value to the manufacturer of gathering and arranging information which does not show directly in the loss and gain account and balance sheet, but which at the same time is exceedingly valuable to the management of the concern in revealing the efficient and non-efficient parts of its organization.

If we consult authorities on statistics, we find that statistics is defined as the science of counting. It is the science which deals with the collection and interpretation of numerical evidence in order to arrive at definite conclusions concerning economic and social phenomena. Murray in his great dictionary defines accounting as "The action or process of reckoning." It is derived from a French word which has in turn been derived from a Latin root, *comput*, meaning a reckoning or counting. From the bare definitions note the similarity of the subject matter of the two sciences, statistics and accounting. Both are sciences of reckoning.

It may seem a little startling to call accounting a statistical science, but as a matter of fact, do we not, either consciously or unconsciously, apply statistical methods in pursuing accounting work? A loss and gain account and a balance sheet are really tables in which are classified

financial data of an enterprise for the purpose of determining certain conclusions about the business. We call the gathering of cost data and other information relating to the efficiency of the plant the collecting of plant statistics. If that is gathering and keeping plant statistics, is not every entry on the other books, whether a purchase or a sale, bills payable or cash payment, or whatever it may be, the keeping of financial or commercial statistics of the business?

Every business has two sides which may be considered the financial and managerial sides respectively. The financial side of a business includes all the transactions which arise between:

1. The firm and stockholders, or between partners;
2. The firm and debtors;
3. The firm and creditors;
4. The income and expenditures of the firm;
5. Its losses and gains;
6. Its assets and liabilities.

The managerial side of the business includes all transactions which arise between:

1. The various departments which produce or sell goods, including the cost of goods both as a whole and by departments.
2. The firm and its employees.

On the financial side the owners of the concern are interested in the sums of money the enterprise is making or losing. On the managerial side they are interested in how it is being made or lost, what is the efficiency of the concern, and how they can further economy in production.

Accounting is the science which shows how to make the records which will tell the financial status of the business, and which shows also the efficiency of departments

and of its employees. It is the science which enables you to determine how losses like depreciation and other things should be distributed. It is the science which enables you to determine the costs of manufacturing goods both as a whole and in each step in the process. It is the science which enables you to compare different methods in carrying on the business so that the officials can determine their policy in management. It does not, however, consider the problems of industrial management and organization. It shows quickly and accurately how different policies in organization and management affect the earning power and productive capacity of the enterprise. In its broad aspect it is a statistical science which tells how to make records and which gets into and shows up the workings of all parts of the concern both financial and managerial. It is the barometer of the business.

A definition which would include all these points and at the same time prescribe its limitations might be expressed as follows: Accounting is that science which treats of the methods of recording transactions in business, and interprets the statements recorded in books and documents so that the layman may have a clear conception of the exact financial and managerial standing of the firm or enterprise both in parts and as a whole.